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INTERNATIONAL CITY MANAGERS' ASSOCIATION
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HOW TO REDUCE MUNICIPAL INSURANCE COSTS

How can a municipality best review its insurance problems with a view to reducing costs and improving practices?

Many municipal officials feel that cities are paying too much for insurance carried on municipal risks, particularly fire insurance. This point of view is supported by the experience of municipalities in ten states where surveys have been made in recent years by state municipal leagues in cooperation with the American Municipal Association. It was found that over a period of ten years the insurance companies paid municipalities approximately $14 for losses sustained out of every $100 of premiums paid by the cities in these states. The best procedures that have grown out of the surveys by several state municipal leagues and from the experience of many cities, as reported to the International City Managers' Association, are briefly set forth here for the benefit of municipal officials who plan to review their practices relating to fire insurance, surety bonds, and liability and theft insurance.

Fire Insurance

There is no one method by which all cities can secure the fire insurance economies to which they are entitled. A large municipality may carry no insurance and meet fire losses when they occur from a reserve fund, out of general revenues, or from bond issues. Another city may carry its own insurance through an insurance reserve fund. Still other cities may carry their insurance with private companies. Cities which carry their own insurance generally should have a large number of risks scattered over a wide area and a debt margin ample to cover the loss of the largest single risk. A small city with comparatively few risks may decide it cannot well afford to carry its own insurance, with or without a reserve fund, because the city might have to assume a serious loss during the early years when the reserve fund available would not cover the loss, and because the city would not be able to take advantage of the fire prevention services offered by the insurance companies.

Some cities insure only their most hazardous risks and do not carry insurance on buildings not generally susceptible to fire loss, such as fire and police stations, waterworks, and sewage disposal plants. Other cities insure only the larger risks--the one that they could least afford to finance without the help of insurance. Still another method of handling fire insurance is partial insurance--a plan under which the city would stand losses up to a certain amount. For example, a small city might take a general policy to cover all losses in excess of $25,000 and would assume all losses up to that amount. This policy is comparable to the widely known deductible policies written on automobiles.

The steps which municipal officials may take in reviewing a city's fire insurance program are:

1. Determine general practices to be followed in handling insurance: (a) extent to which the city will be a self-insurer and extent to which

it will insure risks with commercial companies; (b) whether insurance is to be placed with one company or is to be distributed among local agents and brokers on some objective rather than political basis; and (c) whether bids are to be received from both stock and mutual companies. If insurance has been handled by the several departments and no appraisal has been made in recent years, consider canceling all existing policies and writing new policies on basis of new appraisal and in order that expirations will occur at one time during the year and that premium costs may be distributed evenly over a period of years.

2. Assign to one official, probably the finance officer, the responsibility for the entire insurance program. This official would check all policies and rates, keep records up to date on value of additions to plant, suggest where savings could be effected, be responsible for inspections and reappraisals, check all claims, and collect rebates and losses. He should keep adequate records on all of the city's insurance. Under this plan the insurance agents have only one person to contact, and it is the only way in which an intelligently planned program can be carried out.

3. Determine the insurable value (replacement minus depreciation) of property before buying insurance. The insurance company will not settle for more than the insurable value no matter how much insurance may be carried. The city should make its own appraisal and compare it with that made by the insurance company. The survey should cover premium rates, policy forms, and valuation; and special attention should be given to the type of construction. Municipal officials who survey the insurable value of municipal property should include the city engineer, assessor, attorney, and building commissioner. The survey may reveal that rates applied to particular buildings do not reflect the present hazard either because of improvements made, changes in occupancy or use, changes in exposures and hazards; or the state insurance department may have ordered changes in schedules. For example, in one city a survey showed that the water pumping station was classified as "unprotected" although it was less than three miles from a city fire station and fire hydrants were available to supply water. The classification was changed to a "protected" class and a large saving in premiums effected.

4. Have appraisal data compiled by municipal officials checked by local insurance agents' organization for any significant errors, get insurable value translated into rate and premium terms, and get suggestions on possible structural changes and other steps which would result in premium savings.

5. Compare rates on each individual building with the regulations of the fire insurance rating agency in the state to make certain that the city obtains every credit to which it is entitled and pays for no hazard which no longer exists. There is an individual rate card for every municipal property insured which determines the rate at which insurance will be provided. The rate is usually composed of numerous debit items that increase the rate above the base and some credit items. Compare these debits and credits with actual conditions in each building and look for credits which may have been omitted.

This procedure and the suggestions of the local insurance agents' group should result in securing some ideas on how the risks can be improved by

such methods as installing fire extinguishers and first aid devices, installing sprinkler systems, fire-proofing roofs, providing watch service, installing approved fire doors or wired glass windows, providing standard waste cans, and even by posting "no smoking" signs. Compare the premium saving to be gained from each item against the cost of carrying it out. Insurance rates are being constantly revised because of changes in rating schedules or changes in the physical hazard of individual risks. One reason for high municipal rates is the fact that rates are seldom changed unless the insured requests a rerating. Rates also are affected by changes in protection, occupancy, exposure, and construction.

6. Select type and form of coverage. Consideration should be given to differences between blanket insurance on each site as compared to blanket protection covering all locations. Use the specific schedule type of policy form instead of the general coverage type because there is less red tape in securing a settlement in case of a loss. It is desirable to have as few policies as possible, preferably only one from each agency, to avoid red tape and save time in collecting any claims which may arise. One small city was able to reduce the number of policies from 68 to 12, even though coverage was greatly increased.

7. Consider the use of the co-insurance clause to secure benefit of lower rates by insuring for a certain percentage of the value of the property covered. The usual percentage of co-insurance selected is either 80 per cent or 90 per cent, although some cities carry 50 per cent co-insurance on new fire-resistent buildings.

8. Determine the term of years for which policies are to be written. A premium for a two-year contract is one and three-fourths times the annual premium; for three years, two and one-half times the annual premium; for four years, three and one-fourth times; and for five years, four times the annual premium. This saving can be made, even though the premium is paid annually, by having one-fifth of the insurance expire each year. Investigate the possibility of paying a five-year premium in advance. (One city effected a new saving of 14 per cent in premiums through this procedure even after allowing 4 per cent interest on money borrowed to pay the premiums.)

9. Set up minimum standards for an acceptable insurance company. The simplest rating system for stock companies is "Best's Insurance Guide" (Alfred M. Best Company, Inc., 75 Fulton Street, New York 7) which gives a financial and a management rating to each company. Generally an A:BBB financial rating is the lowest acceptable minimum used by a city. Consider also the scope of the company's business, number of years of successful operation, the plan of full legal reserve, the liquidity and diversification of its assets, ratio of losses paid to premiums written, and character of the management. Also consider the factory mutuals.

10. Consider the fire insurance classification of the city. If a municipality can move from one class to the next better class, for instance from Class 5 to Class 4, there is on the average a reduction of about 5 per cent in commercial insurance rates. A change in the city's classifaction generally calls for a rescheduling of all risks by the rating bureau.

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11. Advertise for bids on the insurable value of the property to be covered. Insurance agencies generally are supposed to charge identical rates, but competitive bidding is desirable even among stock companies because the city may benefit from different interpretations placed on hazard penalties and some companies may provide more service than others in the way of appraisals and inspections. (In one city a mutual insurance company inspects the water and electric plants every 90 days and has suggested the elimination of important but unnoticed hazards.) It should be noted that the stock companies must comply with the official rates and do not give bargain rates. On blanket policies these companies sometimes give the impression of cutting rates, but this is done by reducing the coverage on risks with high rates, and increasing the coverage on risks with low rates so that the average rate is lower. These rates are weighted averages.

The factory mutuals operate in relatively limited fields by selecting risks and by returning to policyholders dividends of 20 to 25 per cent. (One city has received a 50 per cent dividend.) Some mutuals are the nonassessable type or write nonassessable policies, and others limit the amount of the assessment to one year's premium. The contention that municipalities cannot insure in mutuals because they would be lending their credit has been overruled by court decisions in Arkansas, California, North Carolina, and Pennsylvania, and even under an assessable policy the amount of the possible assessment can be insured. For example, one city insuring with a mutual company in order to secure an especially low rate was required to deposit $5,000 with the company. This deposit, while returnable on cancellation of the policy, represented one-fifth of the total amount the city might be assessed by the company. The city protected itself against this possible assessment of $25,000 in a special policy which cost $25 a year.

12. Consult with local insurance agents' association for suggestions on bases for distribution of insurance, if that plan is to be followed. A plan that is a success in one city may not work at all in another. Some objective bases are: total taxes paid by the respective agencies, including taxes of the individual members comprising the agency; size of the agency or the total annual volume of business written; combination of factors such as taxes, volume of business, number of full-time agents employed; whether agents have an established office; number of years the agency has been in business; and the companies for which the agency writes policies. The apportionment of the insurance can be made by the chief administrator and finance officer, or by a committee of local insurance men appointed by the administrator or council, or by a committee selected by the local insurance agents' association--subject in any case to the approval of the council.

It is possible and desirable, even if insurance is to be distributed among a large number of agents, to appoint one broker to handle all insurance. He will distribute it to the agents in accordance with specifications of the municipality. The important reason for insuring through one broker is to make him responsible for giving insurance service on the municipal properties. It too often happens that municipalities secure no insurance service, the many agents only writing their share of the business and doing nothing else.

13. Require that all losses be reported to the finance director, and that settlements be made only with the approval of the department head involved, the law department, and the public insurance committee (if any) of the local underwriters' group.

Surety Bonds

14. Place surety bonds on basis of competitive bidding; in this way some cities have reduced premiums 20 per cent. Secure a $1 minimum on the smallest bond instead of the standard $5 minimum.

15. Official bonds should be furnished by the municipality and paid for out of public funds, and bonds should be purchased only from surety companies whose reputation is good and whose solvency is assured.

16. Bond only those officials or employees who handle money or valuable property which can be converted into money; most cities insure too many employees.

17. The term of official bonds should be limited to one year; new bonds should be issued every year, eliminating renewals. Use a two-year contract if company will allow a discount on second year's premium paid in advance.

18. Use the name-schedule bond where a number of employees are to be covered; such a bond covers the individuals listed regardless of the position held. Use the position bond in cases where cover is desired regardless of who the incumbent may be. The premium generally is lower on the position-type of bond.

19. The amount of the bond should be adequate but not in excess of the financial responsibility of the position held by the employee.

Liability and Theft

20. Eliminate public liability and property damage insurance on motor equipment used in services where the city is totally immune from suit. Insurance companies can assume only such liability as is permitted by law and definitely provided for in the insurance contract. Where the company is not liable there can be no claim for damages. For example, in some states the company is not liable in the case of the strictly governmental functions of fire and police service. In other states, the company is liable in the case of fire and police service only when such services are responding to an alarm or when in the immediate pursuit of an actual or suspected violator of the law.

However, some cities have found that insurance companies will insure the city against any liability even when there is no legal liability against the city. Such companies are willing to attach an endorsement to a policy reading: "It is hereby agreed that in the event of claim arising under this policy the company will not deny liability to the named assured by reason of its being a state, county, municipal corporation or governmental agency." This clause is not included in the standard policy and any insurance company which is willing to write such an endorsement should be investigated very carefully because most companies will not write anything but the standard policy.

21. Consider insuring the personal liability of motor vehicle drivers on a group basis except those drivers of emergency vehicles to whom statutory immunity is granted.

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22. Conduct a continuous safety program in accident prevention among city employees to secure good experience rating. Promote competition among employees and list on a bulletin board the names of employees having accidents each month. As an additional incentive allow employees additional time off for each accident-free three-months period.

23. Place liability insurance after competitive bidding; use the fleet plan in insuring more than five vehicles. One city that has awarded liability insurance on this basis is Berkeley, California. A contract for comprehensive fleet, general public liability, and property damage insurance was given to the lowest of nine bidders who quoted premiums ranging from $16,400 to $23,910 for a three-year policy payable in three equal annual installments. In California a state law makes all cities liable for personal injuries and property damage resulting from the operation of vehicles in any municipal activity.

In Berkeley the limits of liability for any one accident without any aggregate limit are $100,000 for each person and, subject to that limit for each person, $300,000 for each accident, and $100,000 for liability and property damage. The automotive equipment coverage includes 50 trucks; 140 privately owned automobiles operated by city employees, including 92 police automobiles; 29 pieces of fire apparatus and automobiles; and 25 other pieces of equipment. Another city, Sandusky, Ohio, awarded a contract for public liability and property damage insurance on motor equipment to a mutual company which submitted the lowest bid. The city has been able to reduce premiums over the past several years because of the low accident experience. A safety meeting is held once a month for all employees who operate equipment and the accident rate has been reduced by about 70 per cent since these meetings were started.

24. Consider eliminating theft insurance on motor vehicles. Mark each piece of equipment plainly with the name of the municipality and the department. It is not necessary to carry theft insurance on heavy motor equipment such as tractors, street sweepers, large trucks, and fire apparatus.

25. Get credit in burglary and theft insurance policies for the presence of such protective devices as police guards, nightwatchmen, and officials on duty during the day. The type of vault is also considered in determining the rate.

Conclusion

Insurance economies are just as important as other types of administrative economies. Many large cities are able to solve their insurance problems by making provisions to carry their own risks, and smaller cities can expect some reduction in the expenditure for insurance premiums through co-insurance, more accurate appraisals, elimination of hazards, and other types of improved practices. They can also set up a small insurance reserve fund which would be sufficient to cover all their small scattered risks leaving only large risks to be insured.

Municipalities which insure with commercial companies must make certain that they receive any reductions that are ordered. It was discovered in one city that a presumably automatic 25 per cent rate reduction of five years previous had not been put into effect on one large risk, and the

companies would only effect the reduction from the date of notification by the city, so that all effect of the reduction for five years was lost.

The most important methods of reducing insurance costs for the large majority of cities, however, requires collective action on the part of municipalities. The low fire loss experience on municipal properties would seem to justify setting up municipal property along with other public properties as a separate classification for insurance purposes. This was done in California following a survey by the League of California Cities and as a result a new schedule of rates applied on a three-year term basis reduced the rate level 30 per cent below the level of rates applicable to similar privately owned property. In six other states the fire insurance rates on municipal properties have been reduced from 10 to 27 per cent. It is obvious that municipal officials working together on a cooperative basis can secure preferential fire insurance rates for municipal property where it can be shown that present basic rates as applied to such property are unduly high.

NOTE: Cities subscribing to MIS may obtain on request a copy of the proposal form and specifications for fleet, general public liability, and property damage insurance used by Berkeley, California. These specifications were used in purchasing a general comprehensive policy covering the city and all of its officers and employees against all liability of every kind except injuries covered under workmen's compensation laws and damages to city-owned property.

An excellent manual on the handling of fire insurance is a report entitled "Municipal Fire Insurance," issued by the League of California Cities, Hotel Senator, Sacramento. 1941. 50pp. $1. Another useful report is by Robert S. Barnes, "Fire Insurance for Local and State Governments," published by the Municipal Finance Officers' Association, 1313 East 60 Street, Chicago 37. 1945. 22pp. $1. See also "Municipal Fire Administration," published by the International City Managers' Association, 1313 East 60 Street, Chicago 37. 1946. 667pp. $7.50. Chapter 2.